HB 144, HD2

Measure Title:	RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS.
Report Title:	Professional Employer Organizations; Registration; Fees
Description:	Repeals chapter 373L; adds definitions and registration and fee requirements to professional employer organization (PEO) law; requires notice to DOTAX of PEO violations for general excise tax exemption purposes; allows PEOs to be successor employers to client companies; establishes a sliding scale bond requirement for PEOs based upon annual payrolls. Effective July 1, 2112. (HB144 HD2)
Companion:	
Package:	None
Current Referral:	CPN, WAM
Introducer(s):	SOUKI, MCKELVEY, NAKASHIMA

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
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HONOLULU, HAWAII 96809
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To: The Honorable Rosalyn H. Baker, Chair
and Members of the Senate Committee on Commerce and Consumer Protection

Date: Thursday, March 14, 2013
Time: 9:30 a.m.
Place: Conference Room 229, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 144, H.D.2 Relating to Professional Employer Organizations

The Department of Taxation (Department) **appreciates the intent** of H.B. 144 H.D.2, defers to the Department of Labor and Industrial Relations (DLIR) on the merits of this measure, and provides the following information and comments for your consideration.

As it relates to tax, H.B. 144 H.D.2 amends the general excise tax exemption for professional employer organizations at §237-24.75, Hawaii Revised Statutes (HRS), to provide that the exemption is not applicable upon the occurrence of certain specified events. The measure becomes effective July 1, 2112.

With respect to the general excise tax exemption, the Department notes that it has no means of knowing whether a Professional Employer Organization (PEO) is excluding otherwise coverable persons; whether the PEO has failed to properly register with DLIR or to pay any required fees; or whether the PEO is otherwise in compliance with chapter 373K, HRS. These determinations are solely within the province of the DLIR. Therefore, the Department can only suspend the GET exemption upon notification from DLIR that the PEO has failed to comply with its rules and regulations.

To address these concerns, the Department suggests amending this measure to include the GET exemption-related language set forth in S.B. 510 S.D.2. This language will make amendments relating to the timing and notification of the loss of the exemption, as well as other clarifying amendments. An explanation of the amendments included in the S.B. 510 S.D.2. is provided below.

Currently, H.B. 144 H.D.2 amends section 237-24.5, HRS, to clearly set forth the timing of the loss of the exemption upon the occurrence of one of the listed events in subsection 3(D). There is no such timing indicator for the events contained in subsections (3)(A) and (3)(B). Therefore, the Department suggests that subsection 3 of section 237-24.75, HRS, be amended to read as follows to address the timing issues contained in this previous paragraph and the notification issues mentioned in the previous paragraph:

> [-](3) Amounts received[-] by a professional [~~employment~~] employer organization from a client equal to amounts that are disbursed by the professional [~~employment~~] employer organization for employee wages, salaries, payroll taxes, insurance premiums, and benefits, including retirement, vacation, sick leave, health benefits, and similar employment benefits with respect to [~~assigned~~] covered employees at a client company; provided that this exemption shall not apply to a professional [~~employment~~] employer organization [~~upon failure of the professional employment organization to collect, account for, and pay over any income tax withholding for assigned employees or any federal or state taxes for which the professional employment organization is responsible.~~] after:
>
> (A) Notification from the department of labor and industrial relations that the professional employer organization has, by or through any contract between a client company and any professional employer organization, or otherwise, excluded employees from any employee rights or employee benefits required by law to be provided to covered employees of the client company by the professional employer organization;
> (B) A determination by the department that the professional employer organization has failed to pay any tax withholding for covered employees or any federal or state taxes for which the professional employer organization is responsible;
> (C) Notification from the department of labor and industrial relations that the professional employer organization has failed to properly register with the director of labor and industrial relations or to pay fees as required by chapter 373K; or
> (D) Notification from the department of labor and industrial relations that the professional employer organization is not in compliance with chapter 373K.
>
> As used in this in paragraph, [~~"professional employment organization",~~] "professional employer organization", "client company", and [~~"assigned employee"~~] "covered employee" shall have the meanings provided in section 373K-1."

The Department further recommends that subsection (d) of §373K-2, HRS, on page 20 of the bill be amended to read as follows to make the two provisions, both related to the general excise tax, consistent:

> (d) The general excise tax exemption under section 237-24.75 shall not apply to the professional [~~employment~~] employer organization [~~if~~] after:
> (1) Notification from the department of labor and industrial relations that the professional employer organization has, by or through any contract between a client company and any professional employer organization, or otherwise, excluded employees from any employee rights or employee benefits required by

law to be provided to covered employees of the client company by the professional employer organization;

(2) A determination by the department that the professional employer organization has failed to pay any tax withholding for covered employees or any federal or state taxes for which the professional employer organization is responsible;

(3) Notification from the department of labor and industrial relations that the professional employer organization has failed to properly register with the director of labor and industrial relations or to pay fees as required by chapter 373K; or

(4) Notification from the department of labor and industrial relations that the professional employer organization is not in compliance with chapter 373K.

Lastly, the Department recommends the following amendment to make the subsection consistent with section 237-24.75, HRS:

Page 20, line 10, delete "assigned" and insert "covered" in lieu thereof.

The Department estimates that the passage of this bill would be no material effect on tax revenues.

Thank you for the opportunity to provide comments.

NEIL ABERCROMBIE
GOVERNOR

DWIGHT Y. TAKAMINE
DIRECTOR

AUDREY HIDANO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
830 PUNCHBOWL STREET, ROOM 321
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March 13, 2013

To: The Honorable Rosalyn H. Baker, Chair, and
The Honorable Brickwood Galuteria, Vice-Chair,
Members of the Senate Committee on Commerce and Consumer Protection

Date: Thursday, March 14, 2013
Time: 9:30 a.m.
Place: Conference Room 229, State Capitol

From: Dwight Y. Takamine, Director
Department of Labor and Industrial Relations (DLIR)

Re: H.B. No. 144 H.D. 2 Relating to Professional Employer Organizations

I. OVERVIEW OF PROPOSED LEGISLATION

H.B. No. 144 H.D. 2 combines and amends provisions of Chapter 373L and Chapter 373K, Hawaii Revised Statutes (HRS), presumably to clarify responsibilities of the client company and the professional employer organization (PEO), as well as to relieve the onerous financial and administrative requirements contained in the existing statutes.

The DLIR has struggled with implementing the conflicting laws (373L, 373K) in a meaningful way, especially as Act 129 (SLH, 2010) required regulatory functions and expertise outside the scope of the department's existing scope of regulation. Therefore, the DLIR has engaged in internal deliberations and discussions with various stakeholders since the passage of SB2424 SD2HD2CD1, which was vetoed, in order to provide recommendations for the Legislature to deliberate this session. Those recommendations are contained in S.B. 510 S.D. 2.

Overall, the Department supports the intent of H.B. No. 144 H.D. 2, but requests that the contents of this measure be deleted and replaced in its entirety with the language contained in S.B. 510 S.D. 2, which addresses the major concerns of PEOs while maintaining sufficient oversight to safeguard employees' rights and benefits. S.B. 510 S.D. 2 is a collaborative effort, endorsed by its legislative sponsor, the Department of Taxation, and the Department of Labor & Industrial Relations to facilitate implementation by clarifying inconsistencies between two separate, but interrelated chapters in the HRS and limiting regulatory controls to only those essential to preserving the integrity of the PEO industry and the statutorily required benefits and protections of Hawaii's labor laws.

II. CURRENT LAW

Chapter 373K was enacted in 2007 for purposes of qualifying PEOs for the state general excise tax (GET) exemption (GET) under section 237-24.75, whereas Chapter 373L was passed in 2010 to regulate the PEO industry by enforcing registration and bonding requirements. Effective implementation of both laws has been hampered by incompatible language, obscure objectives and lack of a common appreciation of the benefits intended or results to be realized.

III. COMMENTS ON THE HOUSE BILL

DLIR understands that the stakeholders with interest in current PEO legislation are in agreement with the need to reconcile the two PEO chapters and all parties concur that the regulatory functions required by Chapter 373L would be best enforced by tying compliance to the general excise tax exemption provided for in §237-24.75. The department also maintains that the statutes must be simplified and procedures streamlined for PEO registration to proceed and effectively accomplish its objectives.

However, in its present form, HB 144, HD2 contains provisions that challenge these presumptions, including:

1) **Proposed amendments under section 383-66(b)(1) relating to transfer of experience records from the client company to the PEO.** As these transactions cannot be accomplished under the existing UI tax system, <u>these provisions would require overhauling the entire experience rating process at a cost of approximately $23 million</u>. Considering the prohibitive costs, limited staff resources, competing ongoing IT projects, and the inconceivable option of alternative manual processing of the amendments to section 383-66(b)(1), this measure, as is, <u>cannot be implemented.</u>

2) **New proposed language describing the rights and responsibilities allocated between the PEO and the client companies**. It is inevitable that, by including equivocal definitions of "assigned employee", "leased employee", "co-employee", "covered worker", "co-employment", "work site employer" and "offsite employer of record", the PEO registration process will be stifled and the essential protections of affected employees will be undermined. Though apparently distinguishable to the bill's drafters, the ambiguities created by the

multiple definitions will make enforcement of labor laws untenable and result in insurmountable administrative obstacles rather than remedy the existing conflicts in the PEO statutes, as this bill intends.

3) **Additional enforcement responsibilities for the department without funding for positions**. Although prior measures requested a minimum of $177,500 out of state general revenues to carry out its purposes, a similar appropriation is absent in HB 144 HD2. More significantly, the DLIR does not have the experience or expertise to oversee the regulatory controls over businesses as provided in:

   a. Section 373K-E to hold chapter 91 hearings in every case in which the director denies, suspends, revokes or denies renewal of a PEO registration.
   b. Section 373K-F to process judicial reviews filed by PEOs aggrieved by the final decision and order by the director or hearings officer in contested cases.
   c. Section 373K-G to monitor the posting of bonds by PEOs and take necessary legal action to require PEOs that fail to have a current bond in effect to immediately cease doing business in the State.

   The department has consistently supported limited enforcement authority that favors sanctions relating to the GET exemption in lieu of issuing cease and desist orders.

March 13, 2013

TO: The Honorable Rosalyn H. Baker, Chair
The Honorable Brickwood Galuteria, Vice Chair

Members of the Senate Committee on Commerce and Consumer Protection

Date: Thursday, March 14, 2013

Time: 9:30 a.m.

Place: State Capitol, Conference Room 229

Re: House Bill No. 144 HD2 Relating to Professional Employer Organizations ("PEO")

Dear Chair Baker and Vice Chair Galuteria,

My name is Matthew S. Delaney, President of the Hawaii Association of Professional Employer Organizations ("HAPEO"). On behalf of HAPEO, I would like to thank you for this opportunity to share with you and the committee HAPEO's comments as they relate to H.B. No. 144 HD2. **HAPEO strongly supports H.B. No. 144 HD2**. HAPEO believes that this measure will generate new registration fees for the state. HAPEO looks forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry.

Background of PEOs

By way of background, PEOs are businesses that partner with existing small businesses to enable them to cost-effectively outsource the management of human resources, employee benefits, payroll, and workers' compensation. This allows PEO clients to focus on their core competencies to maintain and grow their bottom lines. By forming an employment relationship with these small businesses and their employees, PEOs are able to offer enhanced access to employee benefits, as well as helping small businesses be in compliance with federal and state payroll tax laws, insurance laws, employment laws, and many other required mandates of employers.

History of HAPEO

The people and businesses of Hawaii have a long history of working together, the islands offer a warm and welcoming environment energized by aloha and collaboration. True to this heritage, the Hawaii Professional Employer Organization ("PEO") industry has evolved a positive culture of shared ideas and goodwill. In 2012, a core group of smaller and medium sized Hawaii PEO's formalized their alignment with the establishment of the Hawaii Association of Professional

Employer Organizations ("HAPEO"). Our organization was founded on the principles of transparency and supporting the thousands of small businesses in Hawaii.

HAPEO Membership
HAPEO represents approximately twenty (20) local members, which collectively service over 1,000 small to medium sized businesses in Hawaii and represent over 10,000 worksite employees. HAPEO represents approximately ninety-three percent (93%) of the State's PEOs.

HAPEO's Priorities
Overall, HAPEO strongly supports H.B. No. 144 HD2, but has concerns about provisions pertaining to the scope of the regulatory functions and the allocation of responsibilities regarding compliance with labor laws that may be out of our direct control.

HAPEO has the following three (3) priorities regarding the proposed PEO legislation:

(1) We agree with the Scalable Bond in H.B. No. 144 HD2– It is HAPEO's priority to have a scalable bond as we have detailed out in our prior testimony to equitably represent the sizes of PEOs in annual taxable payroll. We suggest language be inserted that reads: "The total payroll of the professional employer organization shall be the amount reported on the Internal Revenue Service Form W-3, Transmittal of Wage and Tax Statements, filed with the federal government in the year in which the bond is to become effective."

    Letter of Credit
    HAPEO suggests that a Letter of Credit may be used as a substitute for a surety bond.

(2) No Financial Audit – We and the DLIR strongly supports H.B. No. 144 HD2 as currently written with no requirement for audited financial statements.

(3) Definitional Section – HAPEO has been working diligently with DLIR on suggested language changes. DLIR has been open and agreed to some of the suggested changes and has disagreed with other changes. Our dialogue and interaction has been very professional and with the same intent of clearly defining the rights and responsibilities between the DLIR, the PEO and their clients.

    We strongly support the language currently in H.B. No. 144 HD2.

    Co-employment language – Based on testimony previously submitted, the Hawaii PEO industry has fundamental concerns about imposing liabilities on the PEOs activities in which the PEO is unable to control at the Client company worksite. Currently a similar bill in the Senate (SB510 SD2) defines PEOs as "leasing companies" who hires employees and then assigns them to the client's worksite. This is an inaccurate and antiquated interpretation of the current PEO contractual and business model. PEOs operate on a co-employment model in which the employer responsibilities are delineated between the PEO (Administrative Employer) and the Client (Worksite Employer). HAPEO as well as the two large PEOs in the state share this concern. The majority of the states across the country recognize co-employment and the delineation between the PEO and the client and its employees.

2013 Legislative Session

We will continue to work collaboratively with all stakeholders to improve the current laws that were passed back in 2010, and which have still not been implemented in their entirety as a result of challenges with bonding requirements, audited financials, and some other factors. HAPEO is also committed to working with both the DLIR and DCCA to assist in the implementation of the registration process.

HAPEO is also committed to working together with the larger PEOs in the State to insure that consumers are protected by some measure of financial responsibility coupled with healthy competition in the industry. Mahalo for your time and consideration. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

Matthew S. Delaney

Matthew S. Delaney
President of the Board
HAPEO

HiHR
Hawaii Human Resources

March 13, 2013

To: The Honorable Rosalyn H. Baker, Chair
The Honorable Brickwood Galuteria, Vice Chair
Members of the Senate Committee on Commerce and Consumer Protection

Date: Thursday, March 14, 2013
Time: 9:30 a.m.
Place: State Capitol, Conference Room 229

Re: House Bill No. 144 HD2 Relating to Professional Employer Organizations ("PEO")

Dear Chair Baker and Vice Chair Galuteria,

Our names are Matthew S. Delaney, Co-Founder, CEO and President and Scott Meichtry, Co-Founder and Executive Vice-President of Hawaii Human Resources, Inc. ("HiHR"), a locally owned and operated Professional Employer Organization ("PEO") and member of the Hawaii Association of Professional Employer Organizations (HAPEO). On behalf of HiHR, we would like to thank you for this opportunity to share with you and the committee HiHR's comments as they relate to H.B. No. 144 HD2. **Our company and we strongly support H.B. No. 144 HD2.**

HAPEO Members' Priorities

Overall, HAPEO strongly supports H.B. No. 144 HD2, but has concerns about provisions pertaining to the scope of the regulatory functions and the allocation of responsibilities regarding compliance with labor laws that may be out of our direct control.

HAPEO has the following three (3) priorities regarding the proposed PEO legislation:

(1) We agree with the Scalable Bond in H.B. No. 144 HD2– It is HAPEO's priority to have a scalable bond as we have detailed out in our prior testimony to equitably represent the sizes of PEOs in annual taxable payroll. We suggest language be inserted that reads: "The total payroll of the professional employer organization shall be the amount reported on the Internal Revenue Service Form W-3, Transmittal of Wage and Tax Statements, filed with the federal government in the year in which the bond is to become effective."

Letter of Credit

HAPEO suggests that a Letter of Credit may be used as a substitute for a surety bond.

(2) No Financial Audit – We and the DLIR strongly supports H.B. No. 144 HD2 as currently written with no requirement for audited financial statements.

(3) Definitional Section – HAPEO has been working diligently with DLIR on suggested language changes. DLIR has been open and agreed to some of the suggested changes and has disagreed with other changes. Our dialogue and

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interaction has been very professional and with the same intent of clearly defining the rights and responsibilities between the DLIR, the PEO and their clients.

We strongly support the language currently in H.B. No. 144 HD2.
Co-employment language – Based on testimony previously submitted, the Hawaii PEO industry has fundamental concerns about imposing liabilities on the PEOs activities in which the PEO is unable to control at the Client company worksite. Currently a similar bill in the Senate (SB510 SD2) defines PEOs as "leasing companies" who hires employees and then assigns them to the client's worksite. This is an inaccurate and antiquated interpretation of the current PEO contractual and business model. PEOs operate on a co-employment model in which the employer responsibilities are delineated between the PEO (Administrative Employer) and the Client (Worksite Employer). HAPEO as well as the two large PEOs in the state share this concern. The majority of the states across the country recognize co-employment and the delineation between the PEO and the client and its employees.

HiHR is one of the 3 largest PEOs in the State of Hawaii. We currently service 385 different businesses and approximately over 7,000 client worksite employees on all of the major Hawaiian Islands. We formed this company in January 2009 to provide an alternative option for small and medium-sized businesses of Hawaii to outsource their human resource needs and focus on their core businesses. Prior to HiHR entering the market, the market was controlled by two large companies. HiHR is a member of the Hawaii Association of Professional Employer Organizations ("HAPEO").

Mahalo for your time and consideration. We look forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

Matthew S. Delaney
CEO/President

Scott Meichtry
Executive Vice-President

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L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Professional employer organizations

BILL NUMBER: HB 144, HD-2

INTRODUCED BY: House Committee on Consumer Protection & Commerce

BRIEF SUMMARY: Amends HRS section 237-24.75 to replace the term "professional employment organization" with "professional employer organization." Clarifies that the general excise tax exemption shall not apply to a professional employer organization if: (1) the professional employer organization fails to properly register with the department of labor and industrial relations; or (2) the professional employer organization fails to pay any tax withholding for covered employees or any federal or state taxes for which the professional employer organization is responsible.

Makes other nontax amendments to simplify the regulation of the professional employer organization law and clarify the application of existing laws.

EFFECTIVE DATE: July 1, 2112

STAFF COMMENTS: In 2007 the legislature, by Act 225, established HRS chapter 373K to provide that amounts received by a professional employment organization from a client company in the course of providing professional employment services that are disbursed as employee wages, salaries, payroll taxes, insurance premiums, and benefits are exempt from the general excise tax. Act 129, SLH 2010, established registration requirements for the professional employment organizations and established a new HRS chapter 373L. However, this measure repeals HRS chapter 373L and strengthens the provisions of HRS 373K and also clarifies the general excise tax exemption for professional employment organizations.

Digested 2/23/13

Proservice HAWAII
HR ADMINISTRATION

Comments to the Committee on Commerce and Consumer Protection
Thursday, March 14, 2013
9:30 a.m.
Conference Room 229

RE: HOUSE BILL 144 HD2 RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

Chair Baker, Vice Chair Galuteria, and Members of the Committee:

We appreciate your efforts to assure there are reasonable regulations in place to protect our small business and working families who rely on Professional Employer Organizations (PEO) for payroll and mandated insurance and employment benefits. Thank you for the opportunity to submit comments.

SUMMARY OF CONCERNS

- Co-employment language – Based on testimony previously submitted on HB 144 HD2, the Hawaii's PEO industry has fundamental concerns about imposing liabilities on the PEOs on activities PEOs are unable to control on the Client Companies worksite. This concern stems from the current language in HB 144 HD2, which defines PEOs as "leasing companies", who hires employees and then assigned them to the client's worksite. This is an inaccurate and antiquated depiction of the PEO's current business model. Today's PEOs operate on a co-employment model in which employer responsibilities are shared between the PEO and client company. HAPEO (representing many small PEOs in Hawaii), ProService, and Altres share this concern. .

- Bond amounts – the $25,000 and $75,000 sliding scale bond amounts are insufficient to trigger a thorough review by an independent third party. An independent review is paramount ensuring the PEO is responsibly handling client company funds. The lower bond amounts provides little consumer protection, therefore we respectfully suggest the minimum bond amount should be $100,000.

- Audit requirement – If the Legislature prefers not to increase the bond amounts in HB 144 HD2, we ask that the financial audit requirements in HRS 373L be incorporated into the bill. A financial audit requirement will ensure that all PEOs have been reviewed thoroughly by independent third party, a goal that this measure's minimal bond requirement will fail to achieve. As explained below, a financial audit requirement is a power tool for regulators to protect our consumers.

HB 144 HD2 is a compromise to address the concerns of smaller PEOs. We appreciate the efforts to incorporate the ideas and opinions of PEOs of all sizes, but in the attempt to placate smaller PEOs, the bill made adjustments to the registration law (i.e., lowering the bond amount) to the detriment of our small business, working families, and the PEO industry.

I. BACKGROUND

ProService Hawaii provides employee administration services to over 1,000 small businesses in Hawaii, representing over 13,000 employees in Hawaii. As a professional employer organization (PEO), we ensure that our clients remain compliant with Federal and State employment and labor laws, while allowing them to focus on their core business, providing needed and valuable services to the people and the economy of the State. In addition, we ensure that our clients' employees receive timely payment of wages, workers' compensation, TDI and benefits coverage. We also provide HR training and services, dispute resolution, and safety services to our clients and our clients' employees.

Despite some PEOs' claims that there is no need for regulation of the industry, or minimal regulation at best, when PEOs are handling large sums of client funds, the opportunities for misuse or error are present, and such behavior (while fortunately rare), has happened both on the mainland and in Hawaii – in Hawaii as recently as 2007 with a start up PEO. In fact, a simple Google search of the phrase, "fraud PEO" returns a number of instances where PEOs have abused their fundamental responsibilities. Some areas of common abuse are; collecting insurance premiums but not remitting them to the insurance carrier, not paying employees on time, closing business without remitting final paychecks to employees. Because our clients deserve the peace of mind that they have contracted with a reputable PEO, ProService has been voluntarily regulated by the Employer Services Assurance Corporation (ESAC), the gold standard for national independent oversight, auditing, and bonding, since 2006.

We support the efforts of this legislative body to regulate the PEO industry, as it is in this state's and our industry's best interests to have well-functioning firms serving the community. We support the intent of ensuring that only compliant and well-managed PEOs operate in Hawaii.

Under the nationally established PEO Model, there is a co-employment relationship of shared responsibilities between the client company and PEO. The client company, or "worksite" employer, maintains the control of day to day management. The client generally hires and terminates its employees, and not the PEO. The PEO serves as the client's administrative employer - providing payroll services, administering employment benefits – Workers' Compensation Insurance, Health Care Insurance, Unemployment Insurance, and Temporary Disability Insurance. <u>We believe our PEO registration laws should recognize that PEOs operate under a co-employer model with</u>

shared responsibilities. Holding the PEO solely liable for any and all conduct by the client company and/or worksite employee is not good public policy and inconsistent in the way other jurisdictions and federal agencies regulate PEOs. For example, both OSHA and EEOC, along with many state jurisdictions, hold the client or "worksite employer" responsible for conduct at the workplace and limit the PEOs responsibility to the scope of their services provided to the client company under the PEO services agreement.

There is an important distinction between a PEO model and a leasing model. Under an Employee Leasing model, the HR Agent hires and then leases the employees to Client Company. Under a PEO Model, all hiring, termination, and day to day control of the employees are generally in the sole responsibility and discretion of the Client Company.

It is our understanding that most, if not all of Hawaii PEOs operate under a PEO/co-employment Model. Therefore, ProService generally opposes any legislation that does not take this critical factor into account.

II . HOUSE BILL 144 HD2

We offer the following comments on House Bill 144 HD2:

A. **Current Law – HRS 373L.** We recommend that the legislature allows the current law, HRS 373L to be fully implemented and enforced before taking any action on any proposed amendments to the current law. We should look to maintain consumer protections by enforcing the existing law rather than repealing and implementing a new law that has fewer consumer protections.

   1. **The Bonding Requirement in the Current Legislation is Reasonable.**

      a. The bond requirement in HRS 373L is reasonable and is not anti-competitive to smaller PEOs. For example, ProService secured a bond at the required amount of $250,000 for less than $2,000. This cost is nominal for the surety that it provides the Client Companies of the PEO and the State of Hawaii. The bond fee is not a barrier to entry into the marketplace.

      b. We have learned that only two Hawaii based PEOs – Altres and the ProService entities - are in compliance with the bonding requirement of the current law.

      c. HRS 373L-3(3) explicitly provides, "*Failure to have in effect a current bond shall result in automatic forfeiture of registration* *pursuant to this chapter shall require the professional employer organization to immediately cease doing business in the State*."

d. We have learned that many PEOs continue to operate in our state in violation of the HRS 373-3(3). We are not privy to our state government's efforts in enforcing our current PEO registration laws.

2. The Financial Audit Provision Provides Needed Consumer Protection.

a. PEOs handle significant amounts of client funds. A financial audit provides regulators a fundamental tool in protecting our small business and their employees who have relied on PEOs. A financial audit can raise red flags on PEOs that are underfunded or improperly using clients' funds. The financial audit requirements in our current law is not cost prohibitive if the PEO is adhering to general accepting accounting principles, properly funded, and handling clients funds in accordance with best practices. Financial audits are part of PEO registration regulations in most states. It should be viewed as best practice in an industry that handles significant amount of client funds, rather than a hindrance to doing business in Hawaii. Proof of financial stability is imperative given the critical responsibilities that PEOs maintain.

b. According to court documents, in 2007 a start-up Hawaii PEO, Mainstay defrauded its clients by collecting $1,068,579 from its clients in payroll taxes and workers compensation premiums, and not using the funds for their intended purposes. Fortunately for its clients, Mainstay partnered with a Texas company who was financially able to cover those expenses. The Texas company subsequently sued Mainstay for fraud and theft.

c. As the Table A below indicates, even a "small" PEO handles a significant amount client funds. For example, a PEO that has 250 worksite clients will handle approximately $12 million dollars in client funds on annual basis.

Table A

Summary of PEO Pass-Through Funds

By Number of Employees

PEO Pass-Through Funds	250 EEs	500 EEs	1000 EEs	2500 EEs
Covered Employee Annual Payroll	11,150,000	22,300,000	44,600,000	111,500,000
Covered Employee Health Care Premiums	586,307	1,172,613	2,345,226	5,863,065
Client/Worksite Employee State Unemployment Taxes Due	265,085	530,169	1,060,338	2,650,846
Client Company Work Comp Premiums Due	189,550	379,100	758,200	1,895,500
Client Company TDI Premiums Due	44,470	88,939	177,879	444,697
Total Pass-Through Client Funds	**12,235,411**	**24,470,822**	**48,941,643**	**122,354,108**

B. HB 144 HD2 – Three Significant Areas of Concern:

1. Removal of Co-employment Language. As discussed above, PEOs do not "assign employees" to client worksites, but rather enter into co-employment agreements with client companies in which employment responsibilities are shared between parties. The current language inaccurately classifies PEO as "Leasing Companies" by removing the provisions and definitions relating to "co-employment".

   Accordingly, we request the following:

   - The definition of "client company" in Section 373L-1 to remain as follows:

     "Client Company" means any person who enters into a professional employer agreement with a professional employer organization."

   - The definitions of "co-employment" and "covered employee" not be deleted as the worksite employer maintains responsibility for statutory compliance and oversight at the worksite. This definition also supports the fact that it is the Client Company's responsibility to hire employees and that said employees are not "assigned" to the worksite by the PEO.

- The current definition of "Professional Employer Organization" to remain in place rather than deleting the existing definition and replace it with language about employee assignment. Emphasizing employee assignment or leasing could create confusion by inaccurately depicting the PEO model that most Hawaii PEOs operate under.

- The current language in Sec. 373L-B will allow client companies to contract out their liabilities and responsibilities as an employer. Allowing client companies to completely transfer their liability to a PEO will deteriorate self-enforcement that will negatively affect the worksite employees and their families. For example, it will exacerbate the cash-paying economy, which will negatively impact state taxation revenues, unemployment contributions, and the health of the workers' compensation, temporary disability and health care systems.

- Section 373L-B should be amended to state: "During the term of the agreement between a professional employer organization and its client company, the professional employer organization shall be deemed the employer for all assigned employers as defined in section 373L-1, <u>providing the client company has met its obligations and responsibilities under the agreement</u>."

  ProService is agreeable to the PEO being the employer of record for Unemployment Insurance, Workers' Compensation, Temporary Disability Insurance, and Health Care to the extent the client company performs its obligations and responsibilities under the PEO agreement.

2. <u>HB 144 HD2 removes the financial audit requirement</u>

   a. An independent financial audit by a CPA is necessary to verify financial stability and the ability to meet financial obligations. We respectfully ask that the financial audit requirement (373L-2(b)(12) be maintained. The financial audit requirement is reasonable and necessary to provide our regulators a tool to ensure a PEO is financially sound to meet its obligations. Financial audits are part of PEO registration regulations in most other states and are a best practice rather than a hindrance to doing business in Hawaii.

   b. Even small PEOs handle large amounts of client funds. Please see Table A, above. Oversight through a financial audit is proof that a PEO is maintaining financial integrity in the handling of client funds.

c. The cost of an audit is reasonable and in the best interest of protecting consumers.

3. <u>We support a sliding scale bonding requirement</u>.

a. A 3-tier sliding scale in which the amount of the bond will be based on the number of employees listed on the PEO's Unemployment Insurance Quarterly Filings (UC-B6).

b. The amount of the bond will range from $100,000 to $500,000. We believe the amount of the bond should be significant enough to require an independent review of the PEO's practices by a third-party. If the bond requirement is nominal (e.g., $25,000) a medium-size PEO will likely choose to self-fund the bond without going through a third-party's underwriting or review process. Doing so will bypass the protection afforded to consumers through the bond requirement. Accordingly, if the bond requirement is insignificant, we would like you to consider <u>not repealing</u> the financial audit requirement in our current law.

The table below outlines our proposed sliding-scale bonding requirement and the estimated costs for the bond based on Alpha Surety & Brokerage's testimony for 2012's SB 2424.

Number of Employees	Bond Amount	Cost of Bond (1-2% of bond amount)	Pass-through annual payroll
1,000 EEs	$100,000	**$1,000-$2,000**	$44,600,000
5,000 EEs	$250,000	**$2,500-$5,000**	$223,000,000
7,500 EEs	$500,000	**$5,000-10,000**	$334,500,000

We believe our proposal is fair and reasonable in light of: (i) the estimated amount the PEO will likely pay for such bond and (ii) the protection the bonding process will provide our consumers.

III. Conclusion

We respectfully ask that: (1) the current law be enforced; (2) the bonding and financial audit requirements are maintained; and (3) any amendments to the current law take into account the "co-employment" relationship between a PEO and client company. Thank you for the opportunity to submit comments.

ALTRES®

March 13, 2013

The Honorable Rosalyn H. Baker, Chair
The Honorable Brickwood Galuteria, Vice Chair
Committee on Commerce and Consumer Protection
State Capitol
Honolulu, Hawaii 96813

Subject: House Bill 144, HD2, March 14, 2013, 9:30 a.m.

Dear Senators Baker and Galuteria:

My name is Barron Guss, President and second-generation owner of ALTRES, Inc., a 44-year old Hawaii company and Hawaii's oldest Professional Employer Organization (PEO). I am writing you today not in favor or opposition, but with concern that the responsible consumer protection measure of Act 129 is being dissolved in favor of the inadequate companion bills HB144 and SB510, both of which are traveling through the House and Senate.

As you are aware, Act 129 has stringent and responsible bonding and audit requirements. As a result of public outcry, HB144, in its current form, drastically reduces oversight and financial responsibility by the elimination of the audit requirement and the introduction of scalable bonding.

The concept of scalable bonding is not new, as Act 129 also has this flexible provision, but at more appropriate levels. In contrast, HB144 has brought the bonding levels much lower and introduces thresholds of increase at milestones which have no relevance to the market or the exposure.

My testimony today is to urge you to take a second look at the levels and adjust the schedule accordingly. For instance, the average PEO in the Hawaii Association of Professional Employer Organizations (HAPEO) has an annual revenue volume of no more than $5million. Is it truly appropriate to let these businesses grow by more than 500% before you ask them to post a bond of more than $10k? All one has to do is perform a Google search for PEO fraud and you will see why true consumer protection is needed and that HB144 is not only insufficient, it's a slap in the face of those who rely on government protection.

In this session, the HAPEO members have also managed to have this legislature remove the audit requirement. In short, the biggest benefactor of the audit is the PEO itself. An audit will give the PEO operator assurance, guidance and, in the event of looming failure, provide ample notification to make adjustments. I feel the audit requirement on a business is akin to having routine and preventive maintenance on an airplane. If you showed up at the airport and had a choice between an aircraft that received routine maintenance (audit) or one with a parachute ($10k bond) under the seat, which would you choose?

Please forgive me for what I am about to say and the way it sounds. I am the foremost authority in the State on PEOs and their operations. I have operated a PEO for more than 30 years. I have sat as a Board member of the National Association of Professional Employer Organizations (NAPEO) for three terms. I am a founding Board member of the Employer Services Assurance Corporation (ESAC), the entity that audits, scrutinizes and provides bonding to qualifying PEOs. I have worked tirelessly and funded every bit of PEO legislation that has been passed in the State of Hawaii. Finally, it was I who brought my concerns about consumer protection to the DLNR as well as members of the legislature long before many of the current PEOs were even in business. Yet, in spite of my experience and breadth of knowledge, not once have I been contacted personally for my input by any member of the legislature or DLNR this session.

I am close to giving up my fight to get the legislature to put appropriate consumer protection ahead of dissident outcry. For a small group of PEO operators who are not complying with the law (under protest rather than meet their obligations) to have wielded this kind of influence over the legislature is stunning.

My testimony to your committee today is my last-ditch effort to get you to listen to reason and prevent this legislature from letting its guard down and creating bad law.

Respectfully submitted,

Barron L. Guss
President and CEO